

September 10, 2005

Honorable Mayor and Members of the City Council  
City of Long Beach

I have been asked to comment on the City's progress in dealing with its structural deficit and more specifically, the proposal to extend the Three-Year Plan to a fourth year. While I have not been as involved as in previous years, I have followed events and have had the opportunity to review several key City documents including recent budgets and CAFRs.

My report entitled "City of Long Beach Evaluation of Financial Condition" was submitted to the City during May 2003. The report contained several troubling findings:

1. The General Fund had a major structural imbalance with ongoing expenses exceeding ongoing revenues.
2. The gap was not only growing, it was growing at an increasing rate.
3. The problem was masked by the use of one-time revenues, which were used to close the gap.
4. The majority of budgets adopted since 1992 were structurally unbalanced and these budgets appropriated approximately \$90 million more than was funded by ongoing revenues.

Prior to the submittal of my report, the City had already identified the problem and had developed a strategy to deal with it. The most important component of the strategy was a Three-Year Financial Strategic Plan. The plan identified a gap between ongoing revenues and ongoing expenditures of approximately \$90 million. The goal was to close the gap through cutbacks, productivity enhancements and revenue increases.

My Evaluation Report contained several recommendations. The most important was that the General Fund budget be brought back into structural balance. Additional recommendations were that the City Council adopt meaningful goals; that fiscal policies be developed; that the way the budget is balanced be publicly revealed; that a long-term financial plan be adopted, and that debt not be used as a solution.

#### **Reestablish Structural Balance**

In order to reestablish structural balance, ongoing revenues must be equal to or

greater than ongoing expenditures. The original Three-Year Financial Strategic Plan projected a \$90 million deficit that had to be eliminated. Later, this figure was revised to \$102 million.

By the end of fiscal year 2005, the City will have eliminated \$67.5 million or 67 percent of the revised structural deficit (assuming the budget projections are achieved). The proposed 2006 budget assumes structural reductions of another \$22.5 million (\$16.3 million in cost reductions and \$6.2 million in increased revenues). If the Council adopts the proposed budget, this will leave approximately \$10 million to be dealt with in the fiscal year 2007 budget.

Adding a fourth year to the Financial Strategic Plan makes good fiscal and management sense. Significant progress has been made and the goal has almost been achieved. While the remaining \$10 million of the structural gap appears to be small in relation to the \$102 million target, it may be the most difficult to achieve since the City has trimmed most general fund programs and reduced staffing levels throughout the City. As long as the focus is kept on eliminating the imbalance, extending one year may provide the City additional fiscal and management options to achieve the goal. Adding a fourth year to the Financial Strategic Plan also will help the City consolidate gains and possibly avoid major infrastructure and employee recruitment problems.

While addressing the deficit, the City has delayed across-the-board salary increases and has deferred infrastructure investments. While necessary components of the recovery strategy for the past few years, continuing these measures can lead to greater expense to the City in the future, if they are not reversed. Deferring infrastructure investment to later years does not save money. Studies show as repairs are ignored, the costs increase geometrically.

Regarding salaries, the City of Long Beach must compete in the outside job market to attract and retain quality personnel. The lower the City's competitive position falls, the more difficult it will be to attract employees. More importantly, the City will begin to lose experienced personnel to other agencies that offer higher salaries. Not only does the City lose valuable employee experience, it also incurs new recruitment and training costs.

The dilemma is to continue the unwavering focus on eliminating the structural deficit while identifying and addressing potential higher cost impacts. The City Manager's proposed budget appears to achieve this.

Regarding the Evaluation Report recommendations, the City has made significant strides in implementing them.

### **Adopt Meaningful Goals**

The City Council has held a goal setting session and has developed and published their stated priorities in the Annual Budget. The ten stated priorities were used in the development of the annual budget. The goal setting process should be institutionalized and held every year.

### **Develop and Enforce Effective Fiscal Policies**

The Evaluation Report recommended that the City adopt fiscal policies. These policies establish standards, which are used by the City Council to oversee budget and financial activities. Staff uses the policies to develop and administer the budget and financial activities. The City has adopted ten powerful fiscal policies that will help protect the City's financial condition if they are used. Especially important are the policies that require a structurally balanced budget and restricting one-time revenues for one-time expenses. This will help avoid the temptation to add back programs and positions with one-time sources such as a spike in revenue or impact fees. Another policy that must be utilized is the one that requires that the City Manager include a narrative that concisely describes how the budget is balanced. This provides an early alert to potential budget problems.

### **Develop a Long-Term Financial Plan**

A long-range financial plan has not been adopted. Instead, the City has been using the Financial Strategic Plan as an outline for longer-range decisions. The City has also undertaken an ongoing financial analysis using the Financial Trends Monitoring System developed by the International City/County Management Association. This is an excellent system that assesses multiple financial, economic, environmental and intergovernmental factors to project financial condition.

### **Avoid Debt As a Bailout Method**

Notwithstanding the State of California example, the City has not used debt as a method to attempt to bridge the operating gap. Debt postpones the problem and leads to a great deficit. It also places a financial burden on future taxpayers without providing them the benefit. Not only has the City shunned the use of debt, it has maintained the Emergency Reserve at 10 percent of operating expenditures while building the Operating and Infrastructure Reserves.

### **Implement a Performance Based Budgeting System**

The City has also made progress in implementing Performance Management Initiatives including: Strategic Business Plan Development and formatting the new Performance based Program Budget. This as a means of institutionalizing business process improvement efforts throughout the organization and better aligning staff efforts with City Council and community priorities. The City should continue these efforts as a way of doing business. To this point there has been no dedicated staff assigned to support this effort and it could easily lose focus if not held as a priority by the City Council and City Manager.

### **Conclusion**

In my opinion, the three most important steps that can be taken to deal with a structural deficit are to:

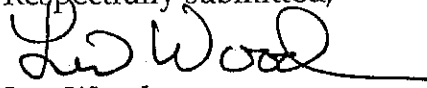
1. Admit that a structural deficit exists
2. Implement a realistic plan to deal with it
3. Stick to the plan until absolute solvency is achieved

The City of Long Beach has taken these steps seriously, and the progress in reducing the structural deficit has been outstanding. If the City Council adopts the recommendations included in the 2006 budget, 90 percent of the structural deficit will be eliminated. Reversing a downward trend and at the same time, eliminating 90 percent of a structural gap is a tremendous accomplishment.

The City also has made significant progress in implementing the recommendations contained in the Evaluation of Financial Condition Study. Continuing to adhere to these recommendations will help the City to identify an impending fiscal crisis and avoid the draconian measures to right an adverse fiscal situation in the future.

As a concluding thought, I would like to express a strong cautionary note. The City Council must not settle for "almost achieving" the goal of solvency. After this budget is adopted, and hopefully, successfully implemented, a \$10 million gap will still exist. The ultimate target has to be structural balance in which ongoing revenues equal or preferably, exceed ongoing expenditures. To settle for a less precise benchmark will make it too easy to relapse into the irresponsible fiscal practices of the past and again endure the pain that must be suffered to resolve the imbalance.

Respectfully submitted,



Len Wood